IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 122 of 1988

For Approval and Signature:

Hon'ble MR.JUSTICE B.C.PATEL Sd/-
and
Hon'ble MR.JUSTICE D.A.MEHTA Sd/-

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : NO

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

KALINDI INVESTMENT P LTD

Versus

COMMISSIONER OF INCOMET TAX

Appearance:

1. INCOME TAX REFERENCE No. 122 of 1988

MR BD KARIA WITH MR RK PATEL for Petitioner No. 1

MR AKIL QURESHI FOR MR MANISH R BHATT for Respondent No. 1

CORAM : MR.JUSTICE B.C.PATEL
and
MR.JUSTICE D.A.MEHTA

Date of decision: 11/12/2001

ORAL JUDGEMENT

(Per : MR.JUSTICE D.A.MEHTA)

1 The Income Tax Appellate Tribunal, Ahmedabad Bench 'B' has referred the following question for the opinion of this Court under section 256(1) of the Income Tax Act,1961 (hereinafter referred to as 'the Act') :

"Whether, on the facts and in the circumstances of the case, the claim on account of interest was allowable?"

2 The assessment years involved are 1978-79, 1979-80 and 1980-81, while the relevant accounting periods are financial years ended on 31/3/1978, 31/3/1979 and 31/3/1980 respectively. The assessee is a limited company in which the public are not substantially interested. The Income Tax Officer disallowed the sum of Rs.6,87,170/- for assessment year 1978-79, Rs.8,42,610/for assessment year 1979-80 and Rs.8,63,054/for assessment year 1980-81 holding that the assessee's claim under section 57(iii) of the Act was not allowable in view of the fact that the expenditure on interest had not been laid out wholly and exclusively for the purpose of making or earning such income. The C.I.T.(Appeals) held that the disallowance had correctly been made by the Income Tax Officer; however, for the later two years the disallowance was restricted to Rs.6,87,170/- as in the first year viz. assessment year 1978-79.

3 It appears that the assessee company borrowed Rs. 1,50,00,000/-. The interest paid was claimed as deductible item of expenditure incurred for the purpose of making or earning income. The borrowings were invested in Wadi Investments Pvt.Ltd. to the tune of Rs.11,66,000/- and towards purchasing shares of Telerad Private Limited to the tune of Rs.1,38,82,000/-. For the present reference we are only concerned with the transactions relatable to Telerad Pvt.Ltd. The shares were purchased on 5/2/1977, and it is an undisputed fact that the entire share capital was transferred to one Ofisade Pvt.Ltd. at the book value on 14/2/1977. It was in the backdrop of this fact situation that the interest was disallowed by the lower authorities as stated hereinabove and such disallowance came to be confirmed by the Tribunal.

4 Mr.B.D.Karia, learned Advocate for the applicant-assessee submitted that the Company was carrying on business of investments i.e. it was an investment company and it was out of commercial

consideration, that it had entered into the aforesaid transactions and incurred liability to pay interest on the borrowings made by it. He submitted that the transfer of the entire shareholdings of Telerad Pvt.Ltd. which was acquired out of borrowed funds was transferred to Ofisade Pvt.Ltd., wholly owned subsidiary company, only with a view to indirectly facilitate carrying on the activity of Ofisade Pvt.Ltd. which is a source of income. Elaborating on this submission, it was submitted that Telerad Pvt.Ltd. was a manufacturing unit while the assessee company was an investment company and hence to ensure that the manufacturing activities were carried on efficiently the unit was transferred to Ofisad Pvt.Ltd. which was a manufacturing company. That the borrowing made by the assessee company and the liability to pay interest on such borrowing was incurred and the assessee's claim had to be appreciated in light of the fact that the assessee fulfilled all the requirements of Section 57(iii) of the Act, i.e. the expenditure was neither in the nature of capital expenditure or personal expenditure in the hands of the Company. In support of his submission Mr.Karia placed reliance upon the decision of this Court in the case of Smt.Virmati Ramkrishna vs. C.I.T., 131 I.T.R.659 and specifically drew our attention to the various tests laid down by the Court at page 672 of the report. He read test No.(vii) with great emphasis and submitted that the case of the assessee company fell within the said test and thus Tribunal had committed an error in holding that the assessee was not entitled to the deduction as claimed.

5 As against this, Mr.Akil Qureshi, learned Standing Counsel for the revenue relied upon the order of the Tribunal as well as the orders of the authorities below and submitted that all the three authorities had found on facts that the assessee had failed to establish nexus between the expenditure incurred and the purpose for which the expenditure had been incurred viz. making or earning of the income. He further submitted that from the facts available on record it was apparent that the purpose of borrowing was not the sole purpose and hence, in light of the test laid down by this Court in the case of Virmati Ramkrishna (Supra) there was no case made out to interfere with the decision of the Tribunal. Mr.Qureshi also relied upon the decision of this Court in the case of Sarabhai & Sons Pvt.Ltd. vs. C.I.T. 201 I.T.R.464 in support of his submissions.

6 Having heard both the sides we do not find any good reason to interfere with the order of the Tribunal for the following reasons :

7 Section 57(iii) of the Act is relatable to deductions allowable against the income chargeable under the head - "Income from other sources". As to what is income from other sources is laid down in Section 56 of the Act which specifically states that it is income which is not chargeable to income tax under any of the heads specified in Section 14, items A to E. Therefore, on conjoint reading of the various provisions of the Act and applying the said provision and the facts found by the Tribunal it is apparent that the assessee company was not carrying on any business and thus was not having income which would fall within the head 'Income from business or profession' or any of the other heads specified in Section 14 of the Act. The assessee company has admittedly claimed deduction of interest against income from other sources i.e. dividend and interest income, but such dividend and interest income is not earned from the investment made in shares of Telerad Pvt.Ltd. or any other investment made which is relatable to transaction in question. Therefore, on a plain reading of the provision in light of the facts found there is no making or earning of income relatable to the transaction in question.

8 Next question that would arise that in light of the settled legal position: it is not necessary that any income must actually have been earned for the purpose of claiming deduction: do the facts of the case go to show that even that condition is applicable ? The Tribunal has found from the facts that the source of income (shares) has altogether disappeared. In relation to this finding Mr.Karia during the course of his submissions contended that the Tribunal had committed an error in recording this finding because what had happened was that the assessee company had converted from one form of investment to another form of investment when shares of Telerad Pvt.Ltd. were transferred to Ofisade Pvt.Ltd. and it was stipulated as per agreement that the consideration shall be received in installments spread over a period of eight years. This contention requires to be stated to be rejected, because it is the consideration for transfer of shares which is payable in installments and that too without interest. It is not as if non receipt of consideration is a form of investment by way of interest bearing deposit; if it was so, the contention might have deserved consideration. Even otherwise, borrowing was not for the purpose of investment by way of outstanding dues. Further more, even if for the sake of argument it is accepted that the outstanding dues would be a form of investment, yet in

the face of the fact that the same was not interest bearing it cannot be said that the borrowing had been utilised for the purpose of making or earning income.

9 On the other hand, the Tribunal has found that the source of income, viz. shares stood transferred and hence the purpose for which the borrowing had been made stood frustrated. In fact the expenditure had not been incurred for preserving and maintaining the source of income nor was it a case where the assessee had no option except to incur the expenditure, but to the contrary, the assessee had option, viz. it was not necessary for the assessee to transfer the shares for claiming the deduction, and yet the assessee exercised option other way by transferring shares which had no connection with the making or earning of the income. Moreover the Tribunal has found that at the highest even on the facts as placed by the assessee on record, the purpose of borrowing was not the sole purpose but was a mixed purpose including reorganization of the investments of the assessee company and even on that count the deduction was not permissible.

10 In view of what is stated hereinbefore we do not find any infirmity with the order of the Tribunal and the Tribunal was right in holding that the assessee's claim on account of interest was not allowable. The question referred is therefore answered in the negative i.e. in favour of the revenue and against the assessee.

11 The reference stands disposed of accordingly. There shall be no order as to costs.

Sd/- Sd/-
(B.C.Patel,J) (D.A.Mehta, J)

m.m.bhatt